

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON NDLAMBE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Ndlambe Local Municipality set out on pages ... to ... , which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa 2013 (Act No. 2 of 2013 as amended) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Commitments

6. The municipality did not have an adequate and complete contract management system in place for the identification and recognition of contracted commitments and did not disclose commitments as required by *SA Standards of GRAP 17, Property, Plant and Equipment*. Due to the lack of adequate systems in place, it was impracticable to determine the full extent of this understatement. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments to the commitments disclosure note were necessary.

Irregular expenditure

7. The municipality did not disclose irregular expenditure incurred in terms of section 125(2)(d)(i) of the MFMA. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of irregular expenditure. Consequently, I was unable to determine whether any further adjustments relating to irregular expenditure of R69,8 million (2012: R69,8 million) disclosed in note 41 were necessary.

Inventory

8. The municipality did not include RDP houses in inventory as required by *SA Standards of GRAP 12, Inventory*. The municipality did not have adequate systems in place to recognise all RDP inventory at year end. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of inventory. Consequently, I was unable to determine whether any further adjustments relating to inventory disclosed in note 3 were necessary.

Water and electricity losses

9. Water losses of R9,5 million (2012: R Nil) are disclosed in note 48 to the financial statements. The municipality does not monitor water distribution losses, as there are no bulk water meters at the purification works to monitor the amount of water supplied by the municipality. Due to the lack of adequate systems in place, it was impracticable to determine the adjustments required. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments to the material losses disclosure note were necessary.

Employee costs

10. Employee costs disclosed in note 25 to the financial statements is overstated by R1,3 million. The municipality has not adopted a policy for the remuneration of vehicle allowances of employees and is applying repealed legislation in the calculation of vehicle allowances due to employees. Consequently, employee costs is overstated by R1,3 million and receivables from non-exchange transactions is understated by the same amount.

Corresponding figures

11. During 2011-12, I was unable to obtain sufficient appropriate audit evidence regarding amounts disclosed for:
- Government grants and subsidies of R3,2 million as disclosed in note 23.
 - Bulk purchases of R3,2 million as disclosed in note 33.
 - Operating leases of R1,8 million as disclosed in note 34.

Qualified opinion

12. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Ndlambe Local Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended in accordance with *SA Standards of GRAP* and the requirements of the MFMA.

Emphasis of matters

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Significant uncertainties

14. With reference to note 37 to the financial statements, the municipality is the defendant in a number of lawsuits. The ultimate outcome of these matters cannot presently be determined.

Restatement of corresponding figures

15. As disclosed in note 44 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors discovered during 2013 in the financial statements of the Ndlambe Municipality at, and for the year ended, 30 June 2012.

Material losses/impairments

16. As disclosed in note 27 to the financial statements, material losses to the amount of R 13,5 million were incurred as a result of a write-off of irrecoverable trade debtors. Furthermore, note 48 to the financial statements discloses material losses of R13,4 million as a result of water and electricity reticulation losses.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

17. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

18. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
19. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*.

The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

20. The material findings are as follows concerning the usefulness and reliability of the information:

Usefulness of information

Presentation

21. Section 46 of the Municipal Systems Act requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for all of the planned targets not achieved were not reflected in the annual performance report. This was due to a lack of review of reported performance information by senior management.

Consistency

22. The Municipal Systems Act, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. All of the reported objectives, indicators and targets are not consistent with the indicators as per the approved integrated development plan. This is due to performance report not being reviewed for consistency of planned and reported indicators and targets.

Measurability

23. The National Treasury *Framework for managing programme performance information (FMPPI)* requires that:

- Performance targets be specific in clearly identifying the nature and required level of performance. All of the targets were not specific in clearly identifying the nature and the required level of performance.
- Performance targets be measurable. The required performance could not be measured for all of the targets.
- The time period or deadline for delivery be specified. All of the targets were not time bound in specifying a time period or deadline for delivery.
- It must be possible to validate the processes and systems that produce the indicator. A total of 46% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist.

24. This was due to the lack of proper review when targets were decided on and formulated for inclusion in the IDP and management not implementing the *Framework for managing programme performance information*.

Reliability of information

Reliability of selected programmes in the annual performance report

25. The National Treasury *Framework for managing programme performance information (FMPPI)* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.

26. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to water, sanitation, housing and electricity. This was due to limitations placed on the scope of my work due to the institution's records not permitting the application of alternative audit procedures.

Compliance with laws and regulations

27. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

28. The performance management system of the municipality was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan and did not clarify the roles and responsibilities of each role-player in the functioning of the system and did not determine the frequency of reporting and the lines of accountability for performance and did not relate to the municipality's performance

management processes and did not provide for procedures by which the system is linked to the municipality's integrated development planning processes, as required by section 38(a) of the Municipal Systems Act and Municipal planning and performance management regulation 7(2)(c)(e)(f) and (g).

29. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the Municipal Systems Act.
30. The municipality did not set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its IDP as required by section 41(1)(a) of the Municipal Systems Act and the Municipal planning and performance management regulation 1 and 9(1)(a).
31. The municipality did not monitor performance with regard to each of those development priorities and objectives and against the key performance indicators and targets set as required by section 41(1)(a) of the Municipal Systems Act and the Municipal planning and performance management regulation 1 and 9(1)(a).
32. The municipality did not measure and review performance at least once per year with regard to each of those development priorities and objectives and against the key performance indicators and targets set as required by section 41(1)(a) of the Municipal Systems Act and the Municipal planning and performance management regulation 1 and 9(1)(a).
33. The municipality did not take steps to improve performance with regard to those development priorities and objectives where performance targets are not met, as required by section 41 of the MSA.
34. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the Municipal Systems Act.
35. The municipality did not set measurable performance targets for the financial year with regard to each of the development priorities and objectives and key performance indicators set out in the IDP, as required by section 41(1)(b) of the Municipal Systems Act and the Municipal planning and performance management regulation 12(1) and 12(2)(e).
36. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal planning and performance management regulation 14(1)(c).
37. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.

Budgets

38. Monthly budget statements were not submitted to the mayor and relevant provincial treasury, as required by section 71(1) and 87(11) of the MFMA.

Annual financial statements, performance and annual reports

39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
40. The performance management system of the municipality did not provide for the monitoring of performance and for the measuring and review of performance at least once per year, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, as required by section 41 of the Municipal Systems Act.

41. Material misstatements of current assets, current liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Audit committee

42. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
43. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.

Expenditure management

44. Reasonable steps were not taken to prevent irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grant receipts

45. The municipality did not submit quarterly performance reports to the transferring national officer, the provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the DoRA.
46. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant, the Integrated National Electrification Programme Grant, the Local Government Financial Management Grant and the Municipal Systems Improvement Grant and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
47. The municipality did not timeously submit project registration forms, for projects it intends implementing in the financial year 2013/14, to the Department of Local Government, as required by the Division of Revenue Grant Framework, Gazette No.35399.
48. The municipality did not submit MFMA implementation plans to National Treasury to address weaknesses in financial management, as required by the Division of Revenue Grant Framework, Gazette No.35399.
49. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
50. The municipality did not register its master plans for bulk infrastructure with the Integrated National Electrification Programme, as required by the Division of Revenue Grant Framework, Gazette No.35399.
51. The municipality did not submit its signed activity plan and/or in the prescribed format to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
52. The municipality did not submit, within 10 days after the end of each month, its monthly expenditure reports to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
53. Projects funded by the Integrated National Electrification Programme grant were not implemented in line with the details contained in the Integrated Development Plan, as required by the Division of Revenue Grant Framework, Gazette No.35399.

Asset management

54. Capital assets were sold without the approval of the council and/or the accounting officer, as required by section 14(2)(a) of the MFMA and municipal asset transfer regulation 5.

Liability management

55. Guarantees were issued that were not within the limits specified in the approved budget, in contravention of section 50(a) of the MFMA.
56. A guarantee was issued for the Department of Minerals and Energy Affairs without approval by the municipal council, in contravention of section 50(b) of the MFMA.
57. A guarantee was issued for the Department of Minerals and Energy Affairs without the approval of National Treasury, in contravention of section 50(c) of the MFMA.
58. A guarantee was issued for the Department of Minerals and Energy Affairs without a cash-backed reserve which covers the full amount of the potential financial exposure as a result of the guarantee, in contravention of section 50(c) of the MFMA.

Consequence management

59. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
60. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
61. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

Procurement and contract management

62. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
63. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as required by SCM regulation 27(2)(a).
64. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
65. Sufficient appropriate audit evidence could not be obtained that councillors of the municipality did not participate in committees or did not attend meetings evaluating or approving tenders or quotations, in contravention of section 117 of the MFMA.
66. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM Regulation 5.
67. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
68. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
69. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.

70. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
71. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of the Municipal Systems Act.
72. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).
73. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were not invited to apply for such listing at least once a year as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).

Internal control

74. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

75. Leadership have not exercised oversight responsibility in an effective manner with regards to compliance with laws and regulations and financial and performance management. Leadership did not ensure that information required for the preparation of the financial statements was provided on a timely basis to the preparers of the statements resulting in material omissions and corrections being required. In addition, a slow response by management to recurring issues has resulted in repeated contraventions of the supply chain management regulations and irregular expenditure being incurred by the municipality. Action plans are prepared on an annual basis by individual directorates but once combined into a municipal wide action plan there is a lack of ownership of the plan, little progress measurement and no implementation of corrective measures to ensure that the action plan yields the intended results.

Financial and performance management

76. The municipality does not have adequate reconciliation of daily and monthly controls. Record management related to service delivery projects implemented by the municipality is inadequate and insufficient. Detailed registers and supporting documentation are not maintained for commitments, irregular expenditure and RDP housing projects to ensure that this information is readily available for inclusion in the financial statements. This has resulted in financial and performance reports that are not accurate and complete.
77. Compliance monitoring does not occur on a regular basis in all directorates of the municipality. Consequently, routine submissions to regulatory bodies and transferring agents do not occur.
78. Quarterly reports on performance are not prepared for all quarters during the year on a timely basis. A large amount of work is thus required when preparing the annual performance report. Due to the inadequate record management and irregular reporting that occurs during the financial year the annual performance report is neither accurate nor complete.

Governance

79. Detailed risk assessments are prepared within individual directorates but the process of agreeing on the risks and consolidating these into the overall municipal risk assessment is inadequate for the organisation. Subsequently the risk assessment document does not place sufficient emphasis on financial risks and recurring findings included in prior year audit reports. In addition, the risk management process does not adequately address the mitigation of identified risks.
80. The internal audit unit had no impact on audit outcomes as evidenced by the recurrence of prior year qualifications. This is as a result of a poorly staffed internal audit function which does not have sufficient resources to effectively dispense with its duties.
81. The audit committee was not given sufficient time to discharge their function of reviewing the accuracy, reliability and adequacy of the financial statements and as a result the review performed on the annual financial statements did not have the desired impact on the fair presentation thereof as material misstatements were identified during the audit. The audit committee's effectiveness is impaired by the absence of a functioning internal audit unit and credible information for discussion at the audit committee meetings as well as a lack of submission of requested documentation by management to the committee and a lack of management attendance at meetings.
82. Although the Municipal Public Accounts Committee (MPAC) was in place during the financial year under review, the responsibilities of the committee were not sufficiently discharged because it only limited meetings during the year under review and sufficient audit evidence could not be obtained to substantiate that MPAC submitted the required quarterly reports to Council. Due to this the desired impact of this committee was not realised.

Auditor-General

Auditor-General

East London

30 November 2013



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